



1985

Taxation

John M. Collins

Follow this and additional works at: <https://scholar.smu.edu/smulr>

Recommended Citation

John M. Collins, *Taxation*, 39 Sw L.J. 545 (1985)
<https://scholar.smu.edu/smulr/vol39/iss1/23>

This Article is brought to you for free and open access by the Law Journals at SMU Scholar. It has been accepted for inclusion in SMU Law Review by an authorized administrator of SMU Scholar. For more information, please visit <http://digitalrepository.smu.edu>.

TAXATION

by

John M. Collins*

I. LIMITED SALES, EXCISE, AND USE TAX

A. *Application of Tax; Specific Exemption*

IN *Bullock v. Shell Pipeline Corp.*¹ the Austin court of appeals overruled the comptroller's position that property is subject to use tax for storage under section 151.101(a) of the Tax Code² if it is held in Texas for any length of time prior to installation.³ The court held that Shell was exempt from the use tax on pipe used in the construction of a pipeline that carried oil by-products in interstate commerce.⁴ Shell purchased pipe in Alabama for installation in a Texas pipeline, and all the work necessary to prepare the pipe for installation was performed outside Texas. The pipe was transported directly to the construction site as needed and installed approximately three to five days after delivery. The comptroller argued that Shell was subject to the use tax either for storage or use of the pipe in Texas. The comptroller, citing *Bullock v. Lone Star Gas Co.*,⁵ contended that the pipe was held in the state for a sufficient period to subject it to tax for storage. In *Lone Star Gas*, however, the taxpayer admitted that its pipe was stored in Texas, but argued that an exemption to the use tax under article 20.04(G)(3)(a)⁶ applied. The Texas Supreme Court in *Lone Star Gas* held that the storage tax and the use tax were separate taxes with separate exemptions and that the court was not required to address the issue of whether the pipe was subject to the storage tax.⁷ The court of appeals, however, addressed that issue in *Shell Pipeline Corp.* and held that storage requires the keeping and retention of property for future use.⁸ Shell had not kept the pipe longer than necessary for incorporation into the pipeline and thus it did not meet the requisites for storage.⁹

The court then determined that Shell satisfied the requirements for the use tax exemption under article 20.04(G)(3)(a) because the pipe was acquired

* B.A. Duke University; J.D., University of Texas. Partner, Haynes and Boone, Dallas, Texas.

1. 671 S.W.2d 715 (Tex. App.—Austin 1984, writ ref'd n.r.e.).

2. TEX. TAX CODE ANN. § 151.101(a) (Vernon 1982).

3. 671 S.W.2d at 715.

4. *Id.* at 718-19.

5. 567 S.W.2d 493 (Tex.), *cert. denied*, 439 U.S. 985 (1978).

6. See TEX. TAX.—GEN. ANN. art. 20.04(G)(3)(a) (Vernon 1969) (now codified in TEX. TAX CODE ANN. § 151.330(c) (Vernon 1982)).

7. 567 S.W.2d at 496-97.

8. 671 S.W.2d at 718.

9. *Id.* at 719.

outside Texas and transported into Texas for use as a licensed and certified carrier of persons or property.¹⁰ Shell held a permit from the Texas Railroad Commission and the court ruled that the permit was sufficient to make the pipeline a licensed and certified carrier of property.¹¹ The comptroller argued, nevertheless, that he reserved the prerogative to inquire into the nature of the license or certificate from a sister agency to determine whether the license or certificate was one contemplated by the article 20.04(G)(3)(a) exemption. The court dismissed this argument and ruled that the comptroller must recognize the validity of the orders of the Texas Railroad Commission, which has primary jurisdiction over the pipeline and transportation of oil products.¹²

In a second significant sales and use tax case during the survey period, the Austin court of appeals determined that a transaction structured as a sale and lease-back of property was actually a financing transaction to which the sales and use tax does not apply. In *Bullock v. Citizens National Bank*¹³ the bank purchased certain equipment from bank customers and then immediately leased the equipment back to the customers. These transactions were essentially financing transactions used to avoid federal limits on the amount of money that could be loaned to any single customer. The comptroller argued that the transactions met the statutory definition of a sale, which is a transfer of title or possession of tangible personal property.¹⁴ The court stated, however, that all the facts and circumstances relating to the transaction must be reviewed in order to determine whether the transactions were sales or merely leases intended as security.¹⁵ In deciding that the transactions were actually financing devices,¹⁶ the court found the following facts important: (1) the customers retained all indicia of ownership before and after the transactions; (2) the customers retained responsibility for all maintenance, property taxes, and insurance on the equipment; (3) the customers bore the risk of loss for the equipment; (4) the customers' books and records reflected that payments to the bank were allocated part to principal and part to interest; (5) the bank treated the money received as a loan payment by allocating part to principal and part to interest income; (6) the customers took advantage of the investment tax credits and depreciation expense on the equipment; and (7) the customers had the right to repurchase the equipment from the bank at the end of the lease term for one dollar.¹⁷

10. *Id.*

11. *Id.* at 720. In *Lone Star Gas* the Waco court of appeals had held that receipt of a permit from the Texas Railroad Commission made the pipeline a "licensed and certified carrier." 558 S.W.2d 556, 571 (Tex. Civ. App.—Waco 1977, no writ).

12. 671 S.W.2d at 720. The court relied on II F. COOPER, *STATE ADMINISTRATIVE LAW* 525 (1965). *Shell Pipeline Corp.* may establish an important precedent in questions of conflict between state agencies.

13. 663 S.W.2d 923 (Tex. App.—Austin 1984, no writ).

14. TEX. TAX CODE ANN. § 151.005(1) (Vernon 1982).

15. 663 S.W.2d at 924.

16. The court held the transaction to be a security device based upon the definition of that term in § 1.201(37) of the Texas Business and Commerce Code. TEX. BUS. & COM. CODE ANN. § 1.201(37) (Vernon Supp. 1984).

17. 663 S.W.2d at 924.

In a significant administrative decision the comptroller's office reversed its position on application of the sales and use tax to aircraft used solely or primarily in interstate travel. In Decision 14,170¹⁸ the comptroller ruled that the owner of a jet used solely or primarily in interstate travel was not entitled to exemption from the use tax under section 151.011(e)(1) of the Tax Code.¹⁹ The taxpayer had purchased a jet which he hangered in Dallas, Texas. During a two-year period from 1979 through 1981 the jet made 405 flights, only four of which were confined within the borders of Texas. The taxpayer purposely established a policy of using the jet only in interstate flights to avoid payment of a use tax on the jet. In an earlier audit of the taxpayer the comptroller determined that no use tax was due on a similarly used aircraft. After that decision the Sales Tax Division issued an interoffice memorandum stating that the Texas use tax would not be applicable to an aircraft used exclusively in interstate flights. In reversing this position in Decision 14,170²⁰ the comptroller determined that the exclusion set forth in section 151.011(e)(1) applies only to transportation of property in interstate commerce. Since the jet was brought to Texas from Delaware, and since it was not flown out of Texas permanently, the exclusion did not apply. The comptroller argued that a carrier may acquire a taxable status in a state through its repeated use in that state, notwithstanding the fact that the use of the property is part of an interstate operation.²¹ The comptroller noted that the jet was used on the ground in Dallas as a carrier of persons at the beginning and end of each interstate flight and that the jet was stored in Dallas between flights. The comptroller ruled, therefore, that the taxpayer had used and stored the jet in Texas, within the meaning of paragraphs (a) and (c) of Section 151.011 of the Tax Code.²²

The taxpayer also asserted that Texas could not impose a use tax on the jet without violating the commerce clause of the United States Constitution.²³ The comptroller dismissed this argument, citing *Braniff Airways, Inc. v. Nebraska State Board of Equalization and Assessment*.²⁴ In *Braniff Airways* the United States Supreme Court held that a state may impose a tax on the ownership of property used in interstate commerce.²⁵ The Supreme

18. Tex. Comptroller's Administrative Decision No. 14,170 (1984).

19. TEX. TAX CODE ANN. § 151.011(e)(1) (Vernon 1982) provides: "Neither 'use' nor 'storage' includes the exercise of a right or power over, or the keeping or retaining of, tangible personal property for the purpose of: (1) transporting the property outside the state for use solely outside the state. . . ." See also Tex. Comptroller of Public Accounts, Rule 3.346, [1 TEX.] ST. TAX REP. (CCH) ¶ 66-295, at 7391-92 (Nov. 17, 1981) (defining storage and use).

20. The Comptroller ruled in a similar case that an aircraft leased from an out-of-state seller hangered in Texas and used for three intrastate flights and 100 interstate flights was leased for use in Texas, and the lessee was liable for payment of Texas use tax on the lease payments. Tex. Comptroller's Administrative Decision No. 10,193 (1979).

21. See *Braniff Airways, Inc. v. Nebraska State Bd. of Equalization and Assessment*, 347 U.S. 590, 598-601 (1954); *Greyhound Lines, Inc. v. Board of Equalization*, 419 S.W.2d 345, 349-50 (Tex. 1967).

22. Tex. Comptroller's Administrative Decision No. 14,170 (1984); see TEX. TAX CODE ANN. § 151.011(a), (c) (Vernon 1982).

23. U.S. CONST. art. I, § 8, cl. 3.

24. 347 U.S. 590 (1954).

25. *Id.* at 602.

Court also ruled in 1977 that a state tax may be applied on interstate commerce so long as the activity being taxed has a substantial nexus with the taxing state and the tax is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the state.²⁶ The comptroller found that the facts of this decision satisfied the four elements of this test.

B. Application of Local Sales Tax

In *Bullock v. Delta Industrial Construction Co.*²⁷ the Austin court of appeals determined the situs of a transaction for purposes of application of the local sales tax. Delta purchased construction materials from sellers located in cities that enacted the local sales and use tax. The sellers delivered the purchased materials to a construction site that was not in a city that had enacted the tax. The court agreed with the comptroller that the materials were transferred for consideration and segregated in contemplation of such transfer at the sellers' places of business.²⁸ The court held, therefore, that under article 20.01(K)(1)(a) the sales took place within the jurisdiction of the cities that had adopted the tax.²⁹ Delta then argued that the local sales and use tax contemplated that any tax liability would be paid by the recipient of the sales proceeds. The court dismissed this argument, noting that the sales tax is a transaction tax and that either the seller or the purchaser may be held liable for payment of the tax.³⁰

The comptroller also decided a case that may be important in defining the continuity of intrastate transit of property within Texas. In Decision 14,179³¹ the comptroller ruled that transporting equipment from outside a taxing jurisdiction to a location within a taxing jurisdiction solely for the purpose of performing work on the property before delivering the equipment to its ultimate location permits the local taxing jurisdiction to apply the one percent local use tax on the property. In this case the taxpayer purchased oil rigs from Texas suppliers not located in areas levying the one percent local use tax. The taxpayer then transported the rigs to its yard within a jurisdiction levying the local use tax to add certain electrical and mechanical devices

26. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 287 (1977).

27. 668 S.W.2d 502 (Tex. App.—Austin 1984, no writ).

28. *Id.* at 504. Under TEX. TAX—GEN. ANN. art. 20.01(K)(1)(a) (Vernon 1969), the court found that the transaction satisfied the definition of a sale for purposes of the limited sales, excise, and use tax. 668 S.W.2d at 503-04. This provision is now codified in the Tax Code as § 151.005(1). Article 1066c, § 6.A incorporates in the local sales and use tax the definitions set forth in subtitles A and B of chapter 151 of title 2 of the Tax Code. TEX. REV. CIV. STAT. ANN. art. 1066c, § 6.A (Vernon Pam. Supp. 1963—85); see also *Bullock v. Duni-gan Tool & Supply Co.* 588 S.W.2d 633, 637 (Tex. Civ. App.—Austin 1979, writ ref'd n.r.e.) (sale of product directly from mill should be taxed where segregated and customer takes possession).

29. 668 S.W.2d at 504.

30. *Id.* The court cited the following cases as authority: *Calvert v. Canteen Co.*, 371 S.W.2d 556, 558 (Tex. 1963) (retailer pays tax even if not collected from consumer); and *Young & Co. v. Calvert*, 405 S.W.2d 174, 176 (Tex. Civ. App.—Austin 1966, writ ref'd) (tax imposed was not unconstitutional), cert. denied, 386 U.S. 914 (1967).

31. Tex Comptroller's Administrative Decision No. 14,179 (1983).

and to perform other work, which took an average of seven to fifteen days. The taxpayer then delivered the rigs to areas that did not levy such a tax. The tax division held that delivery into the yard constituted the first use or storage of tangible personal property under sections 4.A and 4.E of article 1066c.³² The administrative judge agreed that the property became taxable upon delivery to the yard within the local taxing jurisdiction because of a cessation of intrastate transit under rule 3.375(a)(3).³³

The comptroller acknowledged that no case law has made a determination of when intrastate transit has terminated and the use or storage tax may be applied, but the comptroller found substantial authority defining cessation of interstate transit. The Texas Supreme Court held that property became subject to local tax when the interruption of interstate transit was not incidental to the transportation or means of transportation.³⁴ The United States Supreme Court has also provided substantial guidance in this area.³⁵ In *Champlain Realty Co. v. Town of Brattleboro*³⁶ the Supreme Court determined that the following considerations were appropriate in deciding when property becomes subject to local taxation while in the course of interstate transit: (1) whether the owner of the property remains in control of the means of transportation; and (2) whether the cessation of transit is for the purpose of facilitating the delivery or is for the benefit of the owner. Although the taxpayer in *Champlain Realty* intended to transport the rigs outside the city limits, it also intended to take the rigs into the city limits to install certain devices and perform other work. Since the taxpayer was always in control of the means of transportation and the cessation of transit was solely for the owner's business needs or advantage, the comptroller determined that the taxpayer would be subject to local tax under the Supreme Court's *Champlain Realty* test. The interruption of transit was not an incidental one, thus the test set forth by the Texas Supreme Court was satisfied.

C. Miscellaneous Comptroller's Decisions

Two additional comptroller's decisions rendered during the survey period merit discussion. In Decision 13,333³⁷ the comptroller held the sales tax

32. TEX. REV. CIV. STAT. ANN. art. 1066c, §§ 4.A, 4.E (Vernon Supp. 1984). These provisions govern the authority of a city to adopt a local sales and use tax, and the application of such a tax. Section 4.A provides that "in every city where the local sales and use tax has been adopted . . . there is hereby imposed an excise tax on the storage, use, or other consumption within such city of tangible personal property purchased, leased, or rented from any retailer. . . ." Section 4.E provides that a sale of tangible personal property consummated within Texas but outside the city will be subject to the local use tax if the item is "first stored, used, or otherwise consumed [in that city] after the intrastate transit has ceased."

33. Tex. Comptroller of Public Accounts, Rule 3.375(a)(3), [1 TEX.] ST. TAX REP. (CCH) ¶ 67-019, at 7438 (Oct. 19, 1979). This rule provides that intrastate transit ceases when the intrastate journey is interrupted for reasons of convenience or business needs of the owner, but not if the interruption is a temporary one necessary and incidental to the transit.

34. *Calvert v. Zanes-Ewalt Warehouse, Inc.*, 502 S.W.2d 689, 692-93 (Tex. 1973).

35. See *Champlain Realty Co. v. Town of Brattleboro*, 260 U.S. 366 (1922); *Bacon v. Illinois*, 227 U.S. 504 (1913); *Coe v. Town of Errol*, 116 U.S. 517 (1886).

36. 260 U.S. 366, 376-77 (1922).

37. Tex. Comptroller's Administrative Decision No. 13,333 (1983).

applicable to charges for repair of equipment owned by out-of-state customers under section 151.056(a) of the Tax Code.³⁸ Under section 151.056(a) a repairman is considered the consumer of tangible personal property that he furnishes and incorporates into the property of his customer if the repair contract contains a lump-sum price covering both the services and the material furnished.³⁹ In this case the taxpayer charged a lump-sum price for repair of certain rotator or other turbine components owned by his customers located outside of Texas. The taxpayer argued that payment of the tax on purchases of repair parts would place an undue burden on interstate commerce in contravention of the commerce clause of the United States Constitution.⁴⁰ The comptroller disagreed and distinguished the only case cited by the taxpayer.⁴¹

In Decision 14,039⁴² the comptroller ruled that the successor owner of a corporation remains liable for sales taxes on sales incurred by prior owners of the corporation. The comptroller noted that a corporation is a legal entity⁴³ and liable for the tax regardless of a change of ownership.⁴⁴ The taxpayer urged that the comptroller should pierce the corporate veil to assess the tax against the underlying owners of the corporation. The comptroller noted that the corporate veil is normally only pierced under extraordinary conditions such as fraud⁴⁵ and that the petitioner would probably not desire that its corporate veil be pierced for all purposes.

D. 1984 Tax Legislation

In the second called session of the 68th Legislature during the summer of 1984, the Texas Legislature passed a major tax bill, primarily to finance improvements in Texas's educational system.⁴⁶ The limited sales, excise, and

38. TEX. TAX CODE ANN. § 151.056(a) (Vernon 1982).

39. *Id.*

40. U.S. CONST. art. I, § 8, cl. 3.

41. The taxpayer cited *J.D. Adams Mfg. Co. v. Storen*, 304 U.S. 307 (1938), for the proposition that a gross receipts tax (imposed by Indiana in that case) on interstate sales to customers in other states was an impermissible burden on interstate commerce because the states in which the customers lived could impose a similar tax upon the same receipts, and no basis existed for apportioning the tax between the two states. The Texas tax in this case, however, was imposed only on the repair parts that were purchased in Texas and consumed in Texas, even though the states to which the repaired items were shipped could impose a tax on a lump-sum amount charged to the customers. The Supreme Court in *J.D. Adams* emphasized that a tax imposed on any other aspect of the manufacturer's activities that was intrastate in nature would be constitutionally permissible even if the tax were measured by the amount of interstate receipts. *Id.* at 313-14.

42. Tex. Comptroller's Administrative Decision No. 14,039 (1984).

43. The comptroller cited *Silco, Inc. v. Calvert*, 482 S.W.2d 56, 58 (Tex. Civ. App.—Austin 1972, writ ref'd n.r.e.), which held that a corporation is a separate legal entity for taxation purposes.

44. Under § 151.613 of the Tax Code, the successor purchaser of a business is liable for taxes owed. TEX. TAX CODE ANN. § 151.613 (Vernon 1982).

45. See *Angus v. Air Coils, Inc.*, 567 S.W.2d 931, 933 (Tex. Civ. App.—Dallas 1978, no writ).

46. Act of July 13, 1984, ch. 31, 1984 Tex. Sess. Law Serv. 462 (Vernon) [hereinafter cited as 1984 Tax Act].

use tax increased from four percent to 4.125%, effective October 2, 1984.⁴⁷ The sale, use, or rental of taxable items will be exempt from this tax increase if the items are used to perform a contract entered into, or to meet an obligation pursuant to a bid submitted, before October 2, 1984.⁴⁸ Two special sales and use taxes also increased. The motor vehicle tax increased from four percent to five percent, effective August 1, 1984,⁴⁹ the interstate motor carrier sales and use tax also increased from four percent to five percent, effective October 2, 1984.⁵⁰

The primary thrust of the tax bill was to broaden the sales tax base. The tax now covers a multitude of sales transactions formerly tax exempt, including: (1) most services;⁵¹ (2) computer programs other than custom programs;⁵² (3) contractors' materials used in constructing improvements to realty under contracts with the United States;⁵³ (4) newspapers;⁵⁴ (5) magazine subscriptions;⁵⁵ and (6) cigarettes, cigars, and other tobacco products.⁵⁶ These transactions became subject to the limited sales, excise, and use tax on October 2, 1984.⁵⁷ Services now subject to the tax include: (1) amusement services, which includes the provision of amusement and entertainment, or recreation;⁵⁸ (2) cable television services;⁵⁹ (3) motor vehicle parking and storage services;⁶⁰ (4) services rendered in the repair, maintenance, and restoration of tangible personal property other than aircraft, motor vehicles, and most vessels;⁶¹ and (5) personal services, including massage parlors, escort services, Turkish baths, and laundry, cleaning, and garment services.⁶²

47. 1984 Tax Act, art. 13, § 1, at 552 (to be codified at TEX. TAX CODE ANN. § 151.051(b)).

48. 1984 Tax Act, art. 13, § 6, at 555 (uncodified). Notice of such contracts or bids must have been given to the comptroller by December 1, 1984, for this exemption to apply. This exemption expires September 30, 1987.

49. 1984 Tax Act, art. 1, §§ 6, 7, 8, 10, at 464-66 (to be codified at TEX. TAX CODE ANN. §§ 152.021, .022, .026, .028).

50. 1984 Tax Act, art. 11, at 548-51 (to be codified at TEX. TAX CODE ANN. § 157.102).

51. 1984 Tax Act, art. 7, § 2, at 534 (to be codified at TEX. TAX CODE ANN. § 151.0101). The legislature also amended §§ 151.055, .006, .010 and added §§ 151.0028, .0033, .0045, .0335.

52. 1984 Tax Act, art. 6, at 533-34 (to be codified at TEX. TAX CODE ANN. §§ 151.009, .0031, .0032).

53. 1984 Tax Act, art. 12, at 551 (to be codified at TEX. TAX CODE ANN. § 151.311).

54. 1984 Tax Act, art. 12, § 3, at 552 (to be codified at TEX. TAX CODE ANN. § 151.319(a)).

55. 1984 Tax Act, art. 12, § 4, at 552 (to be codified at TEX. TAX CODE ANN. § 151.320).

56. 1984 Tax Act, art. 2, § 23, at 552 (to be codified at TEX. TAX CODE ANN. § 151.308(3) & (4)).

57. 1984 Tax Act, art. 18, § 1, at 560.

58. 1984 Tax Act, art. 7, § 3, at 535 (to be codified at TEX. TAX CODE ANN. § 151.0028). Specifically excluded from the definition of taxable amusement services are services provided by coin-operated machines and educational or health services if prescribed by a licensed practitioner of the healing art primarily for purposes of education or health maintenance. A sale or purchase of an amusement service occurs upon the transfer of title or possession to an admission ticket for consideration or upon collection of an admission fee. 1984 Tax Act, art. 7, § 6, at 536 (to be codified at TEX. TAX CODE ANN. § 151.005(3)).

59. 1984 Tax Act, art. 7, § 4, at 535 (to be codified at TEX. TAX CODE ANN. § 151.0033).

60. 1984 Tax Act, art. 7, at 534, (to be codified at TEX. TAX CODE ANN. § 151.0101).

61. *Id.*

62. 1984 Tax Act, art. 7, § 5, at 535 (to be codified at TEX. TAX CODE ANN. § 151.045).

The following services, however, are specifically exempted from the tax: (1) services performed on exempt property;⁶³ (2) services rendered by an employee for his employer;⁶⁴ (3) services legally mandated to protect the environment or to conserve energy;⁶⁵ (4) amusement and personal services provided through coin-operated machines operated by the consumer;⁶⁶ (5) amusement services provided by certain organizations and government entities;⁶⁷ (6) services performed directly in manufacturing;⁶⁸ and (7) services performed before September 30, 1987, under certain pre-October 2, 1984, contracts and bids.⁶⁹

New sections 151.0031 and 151.0032 of the Tax Code require that computer programs be taxed as tangible personal property.⁷⁰ Custom computer programs are exempt from the tax and are defined as programs created or significantly modified for a particular customer or developed by a user for his own use or consumption.⁷¹ The comptroller also promulgated new rules concerning the taxation of computer programs. Rule 3.308(b)⁷² now provides that a computer program includes computer game cartridges that allow games to be played on a television set through interaction with a computer or on home computers. In addition, when hardware and custom software are purchased together, sales tax is due on the total charge if the charge for custom software is not separately stated.

The legislature modified the definition of "sales price" or "receipts" in section 151.007(c)(7) of the Tax Code, by removing the exclusion for separately stated charges for transporting property with the sales price fixed F.O.B. at the seller's place of business; a separate charge for transporting property after the sale remains excluded.⁷³

The legislature substantially revised the application of the tax to lease-

63. 1984 Tax Act, art. 7, § 12, at 540 (to be codified at TEX. TAX CODE ANN. § 151.3111).

64. 1984 Tax Act, art. 7, § 9, at 538 (to be codified at TEX. TAX CODE ANN. § 151.057).

65. 1984 Tax Act, art. 7, § 16, at 542 (to be codified at TEX. TAX CODE ANN. § 151.338).

66. 1984 Tax Act, art. 7, § 15, at 541 (to be codified at TEX. TAX CODE ANN. § 151.335).

67. 1984 Tax Act, art. 7, § 11, at 539 (to be codified at TEX. TAX CODE ANN. § 151.3101). An amusement service will be exempt if provided by: (1) the state, a municipality, county, school district, special district, or other political subdivision of Texas, or by the United States, if provided within a national historical district; (2) a nonprofit corporation or association, if the proceeds do not benefit any individual except as services of a purely public charity; (3) a nonprofit corporation organized under Texas law to encourage agriculture if no individual receives a private benefit; or (4) an educational, religious, or law enforcement association or a charitable organization.

68. 1984 Tax Act, art. 7, § 13, at 541 (to be codified at TEX. TAX CODE ANN. § 151.318(a)).

69. 1984 Tax Act, art. 7, § 18, at 542 (to be codified at TEX. TAX CODE ANN. § 151.339).

70. 1984 Tax Act, art. 6, at 533 (to be codified at TEX. TAX CODE ANN. §§ 151.0031, .0032). "Computer program" is defined to mean a series of instructions contained in magnetic tapes, punch cards, printed instructions, or other tangible or electronic media that is coded for acceptance by a computer system. *Id.*

71. 1984 Tax Act, art. 6, at 533 (to be codified at TEX. TAX CODE ANN. § 151.0032).

72. Tex. Comptroller of Public Accounts, Rule 3.308(b), [1 TEX.] ST. TAX REP. (CCH) ¶ 66-132, at 731 (Oct. 19, 1984).

73. 1984 Tax Act, art. 7, § 8, at 538 (to be codified at TEX. TAX CODE ANN. § 151.007(c)(7)).

purchase arrangements. Tax is now applied to the portion of a rental payment credited against the purchase price of an item.⁷⁴ The lessor is required to collect tax on the entire sales price, including the sum of all rental payments, either when the purchaser takes possession of the property or when the first payment is due, whichever is earlier. The lessor formerly collected the tax only on rental payments and on the portion of the sales price that exceeded the rental charges already collected. The legislature established a new exemption for master tapes, discs, films, and other audio or audio-visual works when these products are intended for use in the manufacture or copying of such works.⁷⁵ In addition, the agricultural items exemption under section 151.316 of the Tax Code has been expanded to include seeds or annual plants used to produce feed for horses, mules, work animals, or other tax-exempt animals.⁷⁶

The legislature amended the "occasional sale" definition to specify that: (1) the general exemption for one or two sales of taxable items in a twelve-month period does not apply to amusement services;⁷⁷ (2) an exemption for occasional sales of amusement services is allowed if not more than ten admissions are sold during a twelve-month period by a person who does not habitually engage in providing such services;⁷⁸ (3) the exemption for occasional sales does not apply to rentals or leases of taxable items;⁷⁹ and (4) the exemption does not apply to sales by any person holding a sales tax permit.⁸⁰

Finally, the legislature amended the statute that establishes a presumption that a seller's gross receipts are subject to tax; the seller now must have a properly executed resale or exemption certificate in his possession to avoid the presumption.⁸¹ This specific rule replaces a rule requiring the seller to establish that the sale is exempt. If the comptroller notifies the seller that an exemption certificate is required and the seller fails to obtain such a certificate within sixty days, the seller's deduction for that transaction will be disallowed. Even if the seller obtains the certificate within the sixty-day period, the comptroller may verify the claim for the exemption before allowing any deduction.⁸²

74. 1984 Tax Act, art. 9, § 2, at 546-47 (to be codified at TEX. TAX CODE ANN. § 151.055(b)).

75. 1984 Tax Act, art. 7, § 14, at 541 (to be codified at TEX. TAX CODE ANN. § 151.3261).

76. 1984 Tax Act, art. 9, § 1(c), at 545 (to be codified at TEX. TAX CODE ANN. § 151.316(c)).

77. 1984 Tax Act, art. 7, § 10, at 539 (to be codified at TEX. TAX CODE ANN. § 151.304(b)).

78. 1984 Tax Act, art. 7, § 10, at 539 (to be codified at TEX. TAX CODE ANN. § 151.304(b)(4)).

79. 1984 Tax Act, art. 7, § 10, at 539 (to be codified at TEX. TAX CODE ANN. § 151.304(e)).

80. 1984 Tax Act, art. 7, § 10, at 539 (to be codified at TEX. TAX CODE ANN. § 151.304(f)).

81. 1984 Tax Act, art. 15, §§ 2, 3, at 556-58 (to be codified at TEX. TAX CODE ANN. §§ 151.054, .104).

82. *Id.*

E. Sales Tax Procedure Changes

The comptroller issued new rules governing due dates for sales and use tax returns and other filing requirements to conform to 1983 amendments enacted by the state legislature. Under rule 3.335 all returns must be filed on the twentieth day of the month following the end of the reporting period.⁸³ A taxpayer must now file monthly returns unless he qualifies for payment on a quarterly basis or the tax is prepaid on a quarterly basis. For taxpayers prepaying their taxes, the prepayment percentage increased from 66 $\frac{2}{3}$ percent to 90 percent of the tax due, or an amount equal to the actual net tax liability for the same reporting period of the preceding year. The prepayment discount decreased from two percent to 1.25%, but the discount will be disallowed if the prepayment amount is not sufficient.

II. FRANCHISE TAXES

A. Miscellaneous Comptroller's Decisions

Although no significant cases were decided by Texas courts concerning franchise taxes, the comptroller rendered three important decisions during the survey period. In the first decision the comptroller ruled that sales of advertising space in a Texas newspaper and sales of television and radio advertising time for transmission in Texas constituted gross receipts allocable totally to Texas, regardless of the situs of payor.⁸⁴ This determination is important because the Texas franchise tax is based upon taxable capital of the corporation multiplied by a fraction, the numerator being Texas gross receipts and the denominator being total gross receipts.⁸⁵ Section 171.103 of the Tax Code defines gross receipts allocated to Texas to include, *inter alia*, all services performed in Texas, rentals of property situated in Texas, and other business done in Texas.⁸⁶ The comptroller has consistently ruled that advertising revenue constitutes receipts from the sale of services performed in Texas.⁸⁷ The taxpayer, however, argued that the sale of advertising constituted other business under section 171.103(5), which is normally allocated on the basis of a "location of payor" test.⁸⁸ Since a substantial amount of advertising revenue was derived from payors outside of Texas, application of

83. Tex. Comptroller of Public Accounts, Rule 3.335, [1 TEX.] ST. TAX REP. (CCH) ¶ 66-247, at 7371-72 (Dec. 21, 1983). Under the prior rule the return was required on the last day of such month.

84. Four cases were joined for purposes of the hearing involving the same taxpayer and the same issues. Tex. Comptroller's Administrative Decision Nos. 7,881, 12,808, 12,820, 12,700 (1983).

85. TEX. TAX CODE ANN. § 171.106 (Vernon 1982).

86. TEX. TAX CODE ANN. § 171.103 (Vernon 1982).

87. See Tex. Comptroller's Administrative Decision Nos. 12,307 (1982), 10,028 (1980).

88. TEX. TAX CODE ANN. § 171.103(5) (Vernon 1982). The Texas Supreme Court approved the use of the location of payor test in allocating receipts from intangible personal property in 1967. See *Humble Oil & Ref. Co. v. Calvert*, 414 S.W.2d 172, 180 (Tex. 1967); see also Tex. Comptroller of Public Accounts, Rule 3.403(b)(20), [1 TEX.] ST. TAX REP. (CCH) ¶ 14-061, at 1025 (Aug. 15, 1980) ("location of payor" test is used in determining whether dividends or interest are attributable as receipts from business done in Texas).

the location of payor test to advertising revenue would have significantly reduced the taxpayer's franchise taxes.

The comptroller distinguished several cases cited by the taxpayer for the proposition that the sale of advertising was the sale of an intangible representing other business, rather than a sale of a service. In distinguishing these cases the comptroller relied on the definition of intangible property set forth by the Texas Supreme Court in 1967: "intangibles which lack physical characteristics, are represented by paper evidences such as notes and stock certificates, and are mere evidences of enforceable relationships between persons."⁸⁹ The comptroller concluded that advertisements printed in a newspaper and broadcast over radio or on television can hardly be considered intangible property, whether by the Texas Supreme Court's legal definition or by comparison with examples of intangible property. Rather, the advertisements must be characterized as the sale of services.

The comptroller also noted that in 1975 the tax division promulgated the predecessor to rules 3.403(d)(4) and (5), which provide:

(d) Transactions resulting in Texas gross receipts.

(4) All revenues, including out-of-state advertisements, of a newspaper transacting its primary business activities within Texas constitute Texas receipts, except the revenues from the sale of newspapers outside the State of Texas.

(5) All revenues of a radio or television operation which broadcasts or transmits from stations within Texas constitute Texas receipts.⁹⁰

The comptroller stated that the tax division's interpretation and application of the franchise tax statute, as evidenced by this rule, had been consistent during the entire period under consideration, that the rule had been promulgated during the period in question, and that a departmental or agency interpretation of a statute is entitled to great weight and will be upheld unless clearly erroneous.⁹¹ The taxpayer also argued that advertisers purchase the right to have their messages reproduced, which is similar to the purchase of the rights to reproduce a book or film. The comptroller disagreed with this characterization, stating that the seller receives money upon the sale of rights to a book whether or not the book is reproduced, while an advertiser will not receive any revenue unless the message is actually reproduced.

In a second decision concerning the allocation of gross receipts, the comptroller applied the place of operations test rather than the nerve center test to determine the situs of a joint venture.⁹² In Decision 12,557 the taxpayer

89. *Humble Oil & Ref. Co. v. Calvert*, 414 S.W.2d 172, 175 (Tex. 1976).

90. Tex. Comptroller of Public Accounts, Rules 3.403(d)(4),(5) (1975). This rule was originally rule 026.02.12.013.

91. In a 1976 case the Texas Supreme Court stated that duly promulgated rules that are not inconsistent with the constitution and statutes of Texas have the force and effect of legislation. *Lewis v. Jacksonville Bldg. & Loan Ass'n*, 540 S.W.2d 307, 310 (Tex. 1976).

92. Tex. Comptroller's Administrative Decision No. 12,557 (1983). In an earlier decision the comptroller determined that the principal place of operations is normally the principal place of a partnership's business. Tex. Comptroller's Administrative Decision No. 11,814 (1982).

entered into approximately 130 different partnerships and joint ventures to explore for and produce oil and gas throughout the United States and Canada. The comptroller noted that a joint venture or partnership is treated as a separate entity and that the taxpayer is treated as receiving gross receipts based on its share of the net profits or loss of the entity.⁹³ Since such receipts are treated as receipts from intangible property, if a joint venture is located outside Texas its gross receipts will not be included in determining the franchise tax. The comptroller ruled that the location of each joint venture should be determined by the place of its operations.⁹⁴ In this case the well site would be treated as the situs of each joint venture for purposes of the Texas franchise tax and all profits of the joint venture paid to the taxpayer would be allocated to that location. The comptroller noted that if a joint venture has day-to-day operations spread fairly evenly over more than one state, Texas would be the proper situs for the joint venture since the nerve center of each joint venture was located in Fort Worth.

The third significant comptroller's decision concerning franchise taxes involved whether a reduction of taxable capital is permitted for bonuses to employees and contributions to a profit sharing trust declared, but not paid, by the taxpayer's board of directors during the taxpayer's fiscal year.⁹⁵ The taxpayer's board of directors passed resolutions the day before the end of its 1981 fiscal year stating that the corporation should pay certain bonuses and make a contribution to its profit sharing plan.⁹⁶ The comptroller determined that the directors' resolutions did not create legally enforceable obligations against the taxpayer because the promises were not supported by adequate consideration. The comptroller reasoned that the only consideration was past services, which did not make the promises enforceable.⁹⁷ This decision appears to conflict with a 1977 comptroller decision in which a reduction from surplus was allowed for a reserve account covering a taxpayer's estimated cost of its Christmas gifts to employees to the extent of the actual expenses charged off on the taxpayer's year-end statement.⁹⁷

93. The comptroller cited § 26 of the Texas Uniform Partnership Act and a 1981 Texas Supreme Court case to support his view that Texas law embraces the entity theory of partnerships. See *Haney v. Fenley*, 618 S.W.2d 541, 542 (Tex. 1981). The comptroller promulgated a rule providing that a corporation's receipts from its interest in a joint venture is its share of the net profit of the joint venture. Tex. Comptroller of Public Accounts, Rule 403(b)(19), [1 TEX.] ST. TAX REP. (CCH) ¶ 14-061, at 1023, 1025, (Aug. 15, 1980). Since a partner's interest in a partnership is intangible property, receipts from ownership of a partnership interest are also intangible property, and under *Humble Oil* receipts from such property are allocated on the basis of the location of the payor. For tax purposes a partnership is located in its principal place of business. *McKinney v. Nacogdoches Indep. School Dist.*, 489 S.W.2d 161, 169 (Tex. Civ. App.—Tyler 1972), *modified on other grounds*, 504 S.W.2d 832 (Tex. 1974).

94. Tex. Comptroller's Administrative Decision No. 14,623 (1984).

95. The comptroller held that the taxpayer was not obligated to make the payments to its profit-sharing trusts. If the taxpayer had been able to establish an obligation to make such a contribution based on a contract with the employees or under a statute, rule 3.405(2)(d) would have permitted deduction from surplus for the amount.

96. For this general proposition the comptroller cited A. CORBIN, CORBIN ON CONTRACTS § 235, at 366-67 (1952, one vol. ed.); and *Citibank Nat'l Ass'n v. London*, 526 F. Supp. 793, 803 (S.D. Tex. 1981).

97. Tex. Comptroller's Administrative Decision No. 8,253 (1977).

B. Legislative Changes

The most significant change made by the 1984 Tax Act in the corporate franchise tax area was the application of that tax to banking corporations.⁹⁸ Beginning May 1, 1985, all banking corporations, other than bank holding companies, will be subject to a corporate franchise tax as are other corporations transacting business in Texas.⁹⁹ This legislative action is the result of a holding by the United States Supreme Court that the Texas bank shares tax violated a federal statute by calculating the tax without deducting federal obligations held by banks from the value of bank shares.¹⁰⁰ Because banking corporations could theoretically avoid the bank shares tax by investing in federal obligations, the legislature substituted a franchise tax on bank shares, which was specifically permitted under section 3701 of the Revised Statutes.¹⁰¹

The legislature added new provisions to the franchise tax law to apportion the franchise tax received from a banking corporation among the local taxing units in which the bank has its principal office in Texas.¹⁰² In addition to the regular annual report that all corporations must file, each banking corporation must file a supplemental banking corporation report with the comptroller and send a copy of the report to each local taxing unit in which the bank's principal office in Texas is located.¹⁰³ Banking corporations are also specifically exempted from the provisions of the franchise tax providing for forfeiture of a corporate charter upon late filing or payment of taxes.¹⁰⁴ Banking corporations subject to the tax include state, national, domestic, and foreign banks, and banks organized under section 25 of the Federal Reserve Act, which are Edge Act corporations. Bank holding companies, however, are specifically excluded.¹⁰⁵ The provisions implementing these amendments are effective May 1, 1985, for all banking corporations in

98. 1984 Tax Act, art. 3, at 506-16. The legislature repealed section 171.078 of the Tax Code, which exempted state and federal banking corporations from application of the franchise tax. See 1984 Tax Act, art. 3, pt. B, § 1, at 507.

99. 1984 Tax Act, art. 3, at 506-16. The legislature amended sections 11.02(b)-(d) of the Tax Code to exclude stock in banking corporations from coverage of Texas ad valorem taxes (chapter XI of the Tax Code). The legislature also repealed other provisions of the Tax Code that specifically dealt with application of ad valorem taxes to the stock in banking corporations. 1984 Tax Act, art. 3, pt. A, § 2, at 507. All provisions, however, will remain in effect after January 1, 1985, for purposes of collection and enforcement of ad valorem taxes imposed for tax years beginning before January 1, 1985. 1984 Tax Act, art. 3, pt. A, § 3.

100. *American Bank & Trust Co. v. Dallas County*, 103 S. Ct. 3369, 77 L. Ed. 2d 1072 (1983).

101. 31 U.S.C. § 742 (1976).

102. 1984 Tax Act, art. 3, pt. B, § 7, at 511 (to be codified at TEX. TAX CODE ANN. § 171.401(a); TEX. REV. CIV. STAT. ANN. art. 4366e).

103. 1984 Tax Act, art. 3, pt. B, § 4(b), at 510 (to be codified at TEX. TAX CODE ANN. § 171.2021). Interest and dividends received by banks are treated as gross receipts from business in Texas if the bank has its commercial domicile in Texas. 1984 Tax Act, art. 3, pt. B, § 3, at 508-09 (to be codified at TEX. TAX CODE ANN. § 171.1031).

104. 1984 Tax Act, art. 3, pt. B, § 5, at 510 (to be codified at TEX. TAX CODE ANN. § 171.259).

105. 1984 Tax Act, art. 3, pt. B, § 4(c)(1) (to be codified at TEX. TAX CODE ANN. § 171.2021(c)(1)).

Texas.¹⁰⁶

The legislature also increased the franchise tax rate from \$4.25 to \$5.25 per \$1,000 of capital and the minimum tax from \$55 to \$68 for all corporations.¹⁰⁷ The due date for paying the tax and filing annual tax reports was changed from June 15 to March 15.¹⁰⁸ An extension to June 15 may be obtained if the extension is requested on or before March 15 and the request includes payment of not less than ninety percent of the amount reported as due on the report or 100% of the tax paid in the previous year.¹⁰⁹ The legislature also amended section 171.251 of the Tax Code to require the comptroller to forfeit corporate privileges of a corporation other than a banking corporation if it does not file its required annual report or make payment before June 16.¹¹⁰

III. PROPERTY TAX

In a case of first impression the Houston court of appeals held that shares of stock owned by a nonresident shareholder of a foreign Edge Act corporation doing business in Texas are subject to ad valorem tax. In *City of Houston v. Morgan Guaranty International Bank*¹¹¹ the court of appeals construed the Edge Act¹¹² to permit such taxation and held that a foreign corporation was located in Texas through its Texas branch bank, which subjected the corporation to ad valorem taxes under section 11.02 of the Tax Code.¹¹³ Prior to 1980 Morgan Guaranty International Bank of Houston (MGIBH) was organized and operated as a Texas corporation established under the Edge Act and wholly owned by Morgan Guaranty Trust (MGT), a New York corporation. In 1978 section 25(a) of the Federal Reserve Act was amended to permit operation of branch banks in the United States under the Edge Act. In 1980 MGIBH transferred all of its assets to Morgan Guaranty International Bank (MGIB), a Florida corporation, and all MGIBH operations were converted to a branch operation in Texas under MGIB. MGIB and MGT then obtained a permanent injunction against the city of Houston and the Houston Independent School District to prevent collection

106. 1984 Tax Act, art. 3, pt. B, § 2, at 507-08 (uncodified). A banking corporation in existence on May 1, 1985, with a fiscal year ending in 1984 is required to pay its initial franchise tax liability for the period May 1, 1985, through April 30, 1986, on or before March 15, 1985. All calculations of taxable capital and business performed in Texas are to be made on a basis similar to that used for other corporations. *Id.*

107. 1984 Tax Act, art. 3, pt. D, at 516 (to be codified at TEX. TAX CODE ANN. § 171.002).

108. Act of July 12, 1984, ch. 10, art. 3, 1984 Tex. Sess. Law Serv. 146, 162-65 (Vernon) (to be codified at TEX. TAX CODE ANN. §§ 171.152, .202(b)). These provisions are effective September 1, 1984. The Act of July 12, 1984, ch. 10 will hereinafter be cited as S.B. 27.

109. S.B. 27, art. 3, § 4, at 163 (to be codified at TEX. TAX CODE ANN. § 171.202(c), (d)). The comptroller previously granted discretionary extensions for a maximum of 45 days.

110. S.B. 27, art. 3, § 5, at 163-64 (to be codified at TEX. TAX CODE ANN. § 171.251). Before the amendment the forfeiture date was September 16.

111. 666 S.W.2d 524, 532-33 (Tex. App.—Houston [1st Dist.] 1983, writ ref'd n.r.e.).

112. Federal Reserve Act § 25(a), 12 U.S.C. §§ 611-631 (1982).

113. TEX. TAX CODE ANN. § 11.02(d) (Vernon 1982) (repealed eff. Jan. 1, 1985, by 1984 Tax Act, art. 3, pt. A, § 1, at 507).

of ad valorem taxes on shares of MGIB's stock, arguing that state taxation of its shareholders was not permitted under the Edge Act. In the alternative, MGIB and MGT agreed that if state taxation was not prohibited, Texas law does not specifically permit or authorize imposition of ad valorem taxes against MGIB.

The Edge Act provides that a corporation organized under its provisions is subject to tax by the state in which its home office is located in the same manner and to the same extent as other corporations organized under the laws of that state that are transacting a similar character of business. Additionally, shares of stock in these corporations are also subject to tax as the personal property of the owners or holders in the same manner and to the same extent as the shares of stock in similar state corporations.¹¹⁴ The Edge Act thus authorizes state taxation of both the Edge Act corporation itself and its shares of stock. MGIB did not dispute the authority of Texas to impose ad valorem taxes on MGIBH prior to its reorganization, but MGIB contended that after its operations in Texas were assumed by a branch bank, the branch bank and shares of stock in MGIB, a Florida corporation, were not subject to Texas ad valorem tax. The Houston court of appeals construed the language of the statute as a whole to preclude any specific exemption for branch banking operations.¹¹⁵ The court noted that Congress could have specifically provided for such an exemption, but included nothing in the 1978 amendments.¹¹⁶ The court, therefore, held that the Edge Act, as amended, does not prohibit Texas from assessing ad valorem taxes on shares of stock owned by nonresident shareholders in a banking corporation doing business in Texas.¹¹⁷

MGIB then argued that Texas law did not authorize imposition of such a tax. During 1981 two statutes purportedly, however, authorized taxation of such corporations: article 7166 of the Revised Civil Statutes¹¹⁸ and section 11.02(d) of the Tax Code.¹¹⁹ The court chose to apply the most recently enacted statute, section 11.02 of the Tax Code. Section 11.02(d) provides that Texas has jurisdiction to tax stock in a banking corporation incorporated in Texas or to tax stock in a national bank, located in Texas.¹²⁰ MGIB maintained that it was not a banking corporation, that it was not a state or national bank, and that it was not located in Texas. The court rejected all three of these arguments.¹²¹

The court found it necessary to interpret the terms "located in" and "national bank" in order to reach its decision. MGIB urged a narrow interpretation of these two terms, arguing that the statute required that the

114. Federal Reserve Act § 25(a), 12 U.S.C. § 627 (1982).

115. 666 S.W.2d at 529.

116. *Id.* at 530.

117. *Id.*

118. TEX. REV. CIV. STAT. ANN. art. 7166 (Vernon 1969) (repealed eff. Jan. 1, 1982, by Act of June 13, 1979, ch. 841, § 6(a)(1), 1979 Tex. Gen. Laws 2329).

119. TEX. TAX CODE ANN. § 11.02(d) (Vernon 1982) (repealed eff. Jan. 1, 1985, by 1984 Tax Act, art. 7, pt. A, § 1, at 507).

120. TEX. TAX CODE ANN. § 11.02(d) (Vernon 1982).

121. 666 S.W.2d at 531.

corporation be domiciled in Texas and that it be a national bank organized under the provisions of title 12 of the United States Code, section 21. The court adopted a broader definition for each of the terms, holding that "located in" means doing business in Texas, and that "national bank" means all banks chartered by the federal government as distinguished from those chartered under state law.¹²² Since the ad valorem tax on bank shares was repealed by the 1984 Tax Act, this case will have significance only for foreign Edge Act corporations with branch banking operations in Texas after 1978 but before 1985. Thereafter, such corporations will be subject to the Texas franchise tax on the same basis as other foreign corporations doing business in Texas.¹²³

Three cases decided during the survey period addressed the statutory exemption from ad valorem taxes for religious and charitable organizations. In the first case, *Earle v. Program Centers of Grace Union Presbytery, Inc.*,¹²⁴ the Denton County Appraisal District denied an exemption for a corporation owning a religious retreat on the grounds that section 11.20(a) of the Tax Code¹²⁵ provided an overly broad interpretation of the constitutionally authorized exemption for places of religious worship. The Texas Constitution permits the legislature to exempt places of worship from ad valorem taxes.¹²⁶ Section 11.20(a) of the Tax Code provides an exemption for real and tangible personal property if it is owned by a religious organization, used primarily as a place of regular religious worship, and reasonably necessary for engaging in religious worship.¹²⁷ Although the case was reversed and remanded because of errors in submission of special issues, the court upheld the constitutionality of the statute implementing this exemption.¹²⁸

In *Kerrville Independent School District v. Southwest Texas Encampment Association*¹²⁹ the San Antonio court of appeals upheld the constitutionality of the statutory definition of "religious worship" in section 11.20(e) of the Tax Code. That section defines religious worship as "individual or group ceremony or meditation, education, and fellowship, the purpose of which is to manifest or develop reverence, homage, and commitment in behalf of a religious faith."¹³⁰ The court found that the legislature's definition constituted a reasonable interpretation of the constitutional language.¹³¹ The court declined to overturn the jury's finding that a 64-acre religious retreat constituted an actual place of worship entitled to exemption from ad valorem taxes.¹³² This case and *Grace Union* reflect a broader interpretation

122. *Id.* at 533-34.

123. See 1984 Tax Act, art. 3, at 506-16 (to be codified at TEX. TAX CODE ANN. ch. 171).

124. 670 S.W.2d 777 (Tex. App.—Fort Worth 1984, no writ).

125. TEX. TAX CODE ANN. § 11.20(a) (Vernon 1982).

126. TEX. CONST. art. VIII, § 2.

127. TEX. TAX CODE ANN. § 11.20(a) (Vernon 1982).

128. 670 S.W.2d at 780.

129. 673 S.W.2d 256 (Tex. App.—San Antonio 1984, writ ref'd n.r.e.).

130. TEX. TAX CODE ANN. § 11.20(e) (Vernon 1982).

131. 673 S.W.2d at 259. The court cited a 1976 Texas Supreme Court case that noted the difficulty of defining "worship" and indicated that the legislative interpretation of the constitution was reasonable. See *Davies v. Meyer*, 541 S.W.2d 827, 829 (Tex. 1976).

132. The court, however, did not find that additional lots situated across a public street

of actual places of worship as applied to a religious camp or retreat than might be inferred from the 1976 Texas Supreme Court decision in *Davies v. Meyer*.¹³³

In the third case¹³⁴ the Corpus Christi court of appeals declined to rule on the constitutionality of the definition in section 11.18(c) of the Tax Code¹³⁵ of public charity institutions that may be exempt from taxes under the Texas Constitution.¹³⁶ Section 11.18(c) provides a detailed definition of charitable organizations that will be exempt from tax.¹³⁷ In this case the nonprofit organization did not meet the specific requirements of the statute and the court, therefore, declined to reach the constitutional issue.¹³⁸

The time at which fair market value of property is determined was at issue in another recent case before the Corpus Christi court of appeals.¹³⁹ A gas plant owned by Lo-Vaca Gathering Company was in operation as of January 1, 1978, but shut down in October of 1978. The owner of the plant argued that the fair market value of the plant on January 1 should be determined by taking into account events that occurred later in the year. The court agreed with Matagorda County and ruled that circumstances developing or taking place subsequent to January 1 cannot be considered in valuing property for purposes of ad valorem taxes.¹⁴⁰ The court indicated that if the plant owner presented evidence that proved that the plant shut-down was clearly foreseeable as of January 1, 1978 that fact could have been taken into account in the appraisal.¹⁴¹ The court declined to accept the standard or foreseeability proposed by Lo-Vaca, but rather applied this stricter test requiring that events be definitely foreseeable or clearly foreseeable.¹⁴²

In *Freer Municipal Independent School District v. Manges*¹⁴³ the Texas Supreme Court held that a successor school district derived its power to tax

from the 64-acre tract and used as a buffer to maintain the rustic atmosphere of the camp were entitled to exemption. 673 S.W.2d at 261.

133. 541 S.W.2d 827 (Tex. 1976). In *Davies* the court upheld the trial judge's finding that only a chapel, the minister's residence, and one acre of land qualified for exemption. *Id.* at 829.

134. Willacy County Appraisal Dist. v. North Alamo Water Supply Corp., 676 S.W.2d 632 (Tex. App.—Corpus Christi 1984, no writ).

135. TEX. TAX CODE ANN. § 11.18(c) (Vernon 1984).

136. TEX. CONST. art. VIII, § 2.

137. TEX. TAX CODE ANN. § 11.18(c) (Vernon 1984) provides:

(c) To qualify as a charitable organization for purposes of this section, an organization . . . must:

(1) be organized exclusively to perform religious, charitable, scientific, literary, or educational purposes and . . . engage exclusively in performing one or more of the following charitable functions:

. . . .

(G) acquiring, storing, transporting, selling, or distributing water for public use.

138. 676 S.W.2d at 640.

139. Lo-Vaca Gathering Co. v. Matagorda County, 664 S.W.2d 802 (Tex. App.—Corpus Christi 1984, no writ).

140. *Id.* at 804.

141. *Id.*

142. *Id.* at 804-05.

143. 677 S.W.2d 488, 490 (Tex. 1984).

property within its boundaries from authorization granted by the voters to the predecessor school district in a properly held bond election, even though the successor school district did not seek new voter approval of bonds and taxes. The court reversed a court of appeals judgment and affirmed the trial court determination upholding the right of Freer to assess ad valorem taxes on property within its bounds.¹⁴⁴ The voters of the Benavides Municipal Independent School District, which included the City of Freer prior to 1976, authorized that district to issue bonds and to tax property to retire such bonds. In 1976 Freer voted to assume control of the schools within its city limits and established a school district. Thereafter, the Freer School District extended its boundaries for school purposes only, and this extension included property owned by Clinton Manges. Since the Texas Constitution¹⁴⁵ eliminates the need for new voter approval of bonds and taxes when authorized changes are made in the boundaries of school districts, the court held that a change in the boundaries of the Benavides School District had no effect upon the power to tax.¹⁴⁶ Thus, when Freer took control of its schools by disannexation and extended its boundaries for school purposes, it became responsible for a portion of the debt, and it derived the power to tax to retire these bonds.¹⁴⁷

The 1984 Tax Act repealed the property tax on bank shares, as discussed above.¹⁴⁸ The comptroller has issued rules setting forth specific procedures for appeals to the State Property Tax Board protesting school district market and index value findings, as well as appraisals of transportation business intangibles and apportionment of rolling stock.¹⁴⁹

IV. INHERITANCE TAX

In an interesting case a Texas court of appeals held that adoption of the Texas Uniform Partnership Act in 1962 transformed an interest in a partnership that held real property from an interest in realty to an intangible personal property right for purposes of descent and inheritance tax.¹⁵⁰ The court ruled, however, that this recharacterization of the decedent's partnership interest did not impair the contractual obligations existing at the time

144. *Id.*

145. TEX. CONST. art. VII, § 3-b, which provides that:

No tax for the maintenance of public free schools voted in any independent school district . . . nor any bonds voted in any such district, but unissued, shall be abrogated, cancelled or invalidated by change of any kind in the boundaries thereof. After any change in boundaries, the governing body of any such district, without the necessity of an additional election, shall have the power to assess, levy and collect ad valorem taxes on all taxable property within the boundaries of the districts as changed, for the purposes of the maintenance of public free schools. . . .

146. 677 S.W.2d at 490.

147. *Id.*

148. See *supra* note 99.

149. Tex. Comptroller of Public Accounts, Rules 165.71-.91, [1 TEX.] ST. TAX REP. (CCH) ¶¶ 28-510, -515, -520, -525, -560, -565, -570, -571, -571(a), at 4461-62 (Jan. 6, 1984).

150. *Humphrey v. Bullock*, 666 S.W.2d 586, 592 (Tex. App.—Austin 1984, writ ref'd n.r.e.).

that the act became effective.¹⁵¹ The court, consequently, treated the decedent's interest in the partnership as intangible personal property and included it in his taxable estate for Texas inheritance tax purposes, even though the partnership contained real property located outside of Texas.¹⁵²

The court indicated that the law of the state in which the real property was located would be applied to determine the character of the partnership interest, but the decedent's estate presented evidence concerning the law of the applicable state.¹⁵³ The court, therefore, presumed that the law of the applicable state would be the same as Texas law.¹⁵⁴ The court then delved into a determination of characterization of partnership interests under Texas common law prior to adoption of the Texas Uniform Partnership Act. Although the court determined that an interest in a partnership containing real property would be treated as an interest in realty for probate and inheritance tax purposes under Texas common law, adoption of the Texas Uniform Partnership Act changed this characterization and indirectly altered the laws of descent and distribution.¹⁵⁵ In this case, however, even though rights to inherit and receive property under a will vest at death, the Texas Uniform Partnership Act impaired no obligations under the partnership agreement since the agreement existed at the Act's effective date. Section 4(5) of that Act did not, therefore, prohibit treatment of the partnership interest as property with a Texas situs.¹⁵⁶

V. GROSS RECEIPTS TAX—UTILITY COMPANY

The attorney general issued an opinion approving application of the gross receipts tax under section 182.022 of the Tax Code to a company primarily engaged in transporting natural gas, but that incidentally sold gas to twenty industrial customers along its main pipeline.¹⁵⁷ The attorney general specifically overruled a 1951 attorney general opinion that suggested that this tax applied only to businesses engaged primarily in manufacturing and distributing gas.¹⁵⁸ Under section 182.021 of the Tax Code¹⁵⁹ a utility company is defined to include a person who owns or operates a gas works used for local sale and distribution and located within an incorporated city or town in Texas. Section 182.021 also provides that the business on which the tax is applied includes the providing of gas.¹⁶⁰

The division of the corporation that requested the opinion transported natural gas by pipeline to the Houston ship channel and had an industrial

151. *Id.* at 591.

152. *Id.* at 592.

153. *Id.* at 589. The court cited RESTATEMENT OF CONFLICT OF LAWS § 208 (1934), as authority for its statement as to applicable law.

154. 666 S.W.2d at 589; *see* *Gevinson v. Manhattan Constr. Co.*, 449 S.W.2d 458, 465 n.2 (Tex. 1969); *Ogletree v. Crates*, 363 S.W.2d 431, 435 (Tex. 1963).

155. 666 S.W.2d at 591.

156. *Id.* at 592.

157. Op. Tex. Att'y Gen. No. JM-150 (1984).

158. Op. Tex. Att'y Gen. No. WW-1111 (1951).

159. TEX. TAX CODE ANN. § 182.021 (Vernon 1982).

160. *Id.*

franchise agreement with the City of Houston to sell gas to the city and to industrial users within the city. The pipeline had a system of meters and lateral lines used to deliver gas to the industrial consumers. In a 1957 case the Texas Supreme Court defined "gas works" to include "a distribution system consisting of pipes through which the gas flows and is delivered to the premises of consumers."¹⁶¹ The attorney general noted that, although the majority of the business for which the pipeline was used consisted of transporting natural gas from the well head and gas gathering systems, the pipeline also bore several features of a distribution system. The attorney general, therefore, found the receipts from the sale of natural gas to the industrial consumers subject to the tax imposed by chapter 182 of the Tax Code.

VI. MISCELLANEOUS LEGISLATION

In addition to the changes in the franchise tax law and property tax law discussed earlier, the 1984 Tax Act increased fuel taxes,¹⁶² motor vehicle registration fees,¹⁶³ alcoholic beverage taxes,¹⁶⁴ hotel occupancy taxes,¹⁶⁵ cigarette taxes,¹⁶⁶ insurance gross premiums taxes,¹⁶⁷ and occupation taxes on coin-operated machines.¹⁶⁸ In addition, snuff is now subject to the cigarette tax and is taxed in the same manner as chewing tobacco.¹⁶⁹ An additional change in the alcoholic beverage tax shifts the obligation to pay the tax on beer, ale, and malt liquor from the importer or brewer, as under prior law, to the permittee making the first taxable sale, which is generally the wholesaler or distributor.¹⁷⁰

The legislature also revised the method by which domestic and foreign insurance companies are taxed under article 4.11 of the Insurance Code.¹⁷¹ Under prior law the rate was 1.1% of gross premiums for domestic insurance companies and 3.3% for foreign companies.¹⁷² Article 4.11, as

161. *Eddins-Walcher Butane Co. v. Calvert*, 298 S.W.2d 93, 96 (Tex. 1957).

162. 1984 Tax Act, art. 1, §§ 1, 2, 4, at 462-63 (to be codified at TEX. TAX CODE ANN. §§ 153.102, .202, .301(b)).

163. 1984 Tax Act, art. 1, §§ 11-35, at 466-89 (to be codified at TEX. REV. CIV. STAT. ANN. arts. 6675a-5, -5a, -6a, -6½, -7, -8, -8a, -11a). These increased fees are phased in over a three-year period.

164. 1984 Tax Act, art. 2, §§ 8, 9, 11, 13, 14, at 501-03 (to be codified at TEX. TAX CODE ANN. §§ 201.03(a), .04, .42, 202.02, 203.01).

165. 1984 Tax Act, art. 5, at 533 (to be codified at TEX. TAX CODE ANN. § 156.052). The tax became effective on October 1, 1984.

166. 1984 Tax Act, art. 2, §§ 1, 2, at 497-98 (to be codified at TEX. TAX CODE ANN. § 154.021).

167. 1984 Tax Act, art. 4, at 516-32 (to be codified at TEX. INS. CODE ANN. art. 4.11).

168. 1984 Tax Act, art. 8, at 545 (to be codified at TEX. REV. CIV. STAT. ANN. art. 8802(1)). Coin-operated machines are specifically exempted from application of the sales tax to services. *See supra* note 66 and accompanying text.

169. 1984 Tax Act, art. 2, §§ 6, 7, at 500-01 (to be codified at TEX. TAX CODE ANN. §§ 155.0211, .001(3)).

170. 1984 Tax Act, art. 2, §§ 10, 12, 16, at 501-04 (to be codified at TEX. ALCO. BEV. CODE ANN. §§ 201.41, .43, 203.03).

171. 1984 Tax Act, art. 4, § 1, at 516-32 (to be codified at TEX. INS. CODE ANN. art. 4.11).

172. TEX. INS. CODE ANN. art. 4.11, § 1 (Vernon 1981).

amended, subjects all insurers to a 2.5% gross premiums tax, but permits application of a lower rate if the company's investments in Texas exceed certain standards.¹⁷³ Further, the 1984 Tax Act revised rules regarding quarterly payments of the tax.¹⁷⁴

VII. ADMINISTRATION

The comptroller substantially revised the tax protest rules that apply to disputes involving a tax, penalty, interest payment or assessment, or a permit or license granted or denied by the comptroller. A taxpayer must now request a redetermination hearing within thirty days after a deficiency determination is issued or within twenty days after a jeopardy determination is issued.¹⁷⁵ Refund claims and redetermination hearing requests must include a detailed statement of the grounds on which the claim is founded.¹⁷⁶ The comptroller also tightened the conditions under which extensions for redetermination hearing requests and refund claims will be granted. Such extension requests must be received on or before the original due date, and the director of legal services may only grant extensions in emergencies or for extraordinary circumstances.¹⁷⁷ With respect to any other filing deadline, the request for extension must be made in writing and must be made at least seven days before the deadline.¹⁷⁸ Finally, the comptroller made miscellaneous changes in the rules governing: (1) contents of a statement of grounds for redetermination requests;¹⁷⁹ (2) scheduling of a preliminary conference;¹⁸⁰ (3) delivery of a position letter by the hearings attorney after a hearing and review;¹⁸¹ (4) taxpayer's options when a motion to set a hearing is filed;¹⁸² (5) definitions of "contested case" and "case";¹⁸³ and (6) procedures for inspection of files to maintain confidentiality.¹⁸⁴

The comptroller also amended the regulation that defines "doing business" in Texas for franchise tax purposes to provide that any corporation engaged in construction contracting will be treated as doing business in

173. 1984 Tax Act, art. 4, § 1 (to be codified at TEX. INS. CODE ANN. art. 4.11, § 5).

174. 1984 Tax Act, art. 4, § 2 (uncodified).

175. Tex. Comptroller of Public Accounts, Rule 1.5, [1 TEX.] ST. TAX REP. (CCH) ¶ 89-813, at 8973 (Sept. 1, 1983).

176. *Id.* Under the prior rules the taxpayer was required only to submit a brief statement of the reasons for the claim.

177. Tex. Comptroller of Public Accounts, Rule 1.6, [1 TEX.] ST. TAX REP. (CCH) ¶ 89-815, at 8973-74 (Sept. 1, 1983).

178. *Id.*

179. Tex. Comptroller of Public Accounts, Rule 1.7, [1 TEX.] ST. TAX REP. (CCH) ¶ 89-817, at 8974 (Sept. 1, 1983).

180. Tex. Comptroller of Public Accounts, Rule 1.8, [1 TEX.] ST. TAX REP. (CCH) ¶ 89-819, at 8974 (Sept. 1, 1983).

181. Tex. Comptroller of Public Accounts, Rule 1.9, [1 TEX.] ST. TAX REP. (CCH) ¶ 89-821, at 8974 (Sept. 1, 1983).

182. Tex. Comptroller of Public Accounts, Rule 1.12, [1 TEX.] ST. TAX REP. (CCH) ¶ 89-827, at 8975 (Sept. 1, 1983).

183. Tex. Comptroller of Public Accounts, Rule 1.42, [1 TEX.] ST. TAX REP. (CCH) ¶ 89-891, at 8979 (Sept. 1, 1983).

184. Tex. Comptroller of Public Accounts, Rule 1.19, [1 TEX.] ST. TAX REP. (CCH) ¶ 89-891, at 8976 (Sept. 1, 1983).

Texas, regardless of the amount of time expended in such activities.¹⁸⁵ In addition, the activities of inspecting or repairing goods in Texas under warranty or contract will also be treated as doing business in Texas.¹⁸⁶

An amendment to the comptroller's rules seeks to clarify acceptable auditing methods and the situations in which each method may be adopted.¹⁸⁷ The comptroller may use either a detailed auditing procedure or a "sample and projection" auditing method. The sample and projection method may only be used, however, under the following three circumstances: (1) the taxpayer's records are so detailed and complex or voluminous that a detailed audit would be unreasonable or impractical; (2) the taxpayer's records are inadequate or insufficient; or (3) the cost of the detailed audit would be unreasonable in relation to its benefits. If the comptroller proposes to utilize the sample and projection method, he must notify the taxpayer in advance.

The Texarkana court of appeals decided one significant case in the area of administrative procedure during the survey period. In *Brooks Operating Co. v. Bullock*¹⁸⁸ the court affirmed a lower court ruling that held that the court was without jurisdiction to hear a taxpayer's refund action because the taxpayer had not complied with statutory requirements. Brooks made a payment of diesel fuel taxes and enclosed a letter stating that the taxes were paid under protest and that it reserved all legal rights that might accrue. The letter, however, stated no reason for the protest. In a separate letter mailed approximately one month later, Brooks set forth its reasons for the protest and thereafter filed a refund action. The comptroller made a plea to jurisdiction, arguing that the initial letter was insufficient to confer jurisdiction on the court under article 1.05,¹⁸⁹ which permits payment under protest only if payment is accompanied by a written protest setting out fully all grounds for appeal. The appeals court ruled that the requirements of article 1.05 are jurisdictional and failure to comply fully with these requirements leaves the district court without jurisdiction to hear the protest.¹⁹⁰

185. Tex. Comptroller of Public Accounts, Rule 3.406, [1 TEX.] ST. TAX REP. (CCH) ¶ 14-076, at 1040-41 (Sept. 5, 1983). Under prior law the corporation was required to be engaged in such activities for at least 30 days.

186. *Id.*

187. Tex. Comptroller of Public Accounts, Rule 3.282, [1 TEX.] ST. TAX REP. (CCH) ¶ 66-005, at 7239-40 (Dec. 21, 1983).

188. 668 S.W.2d 733, 735 (Tex. App.—Texarkana 1983, writ ref'd).

189. TEX. TAX.—GEN. ANN. art. 1.05 (Vernon 1960).

190. 668 S.W.2d at 735.